

**NATIONAL  
RATING  
AGENCY**

Agriculture And Seed Industry  
In 2015 – 1H 2016

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# Agriculture And Seed Industry In 2015 – 1H 2016



## Summary

- The most prominent feature of the agriculture industry in 2015 was an expansion of its role in the Russian economy. The year saw an increase in the physical volumes of output of major agricultural crops and animal breeding products with the exception of the dairy sector, where the size of the cattle herd continued to decline, albeit an increase in productivity.
- In value terms, the agricultural production grew by 3.0 percent in 2015 and 2.6 percent in 1H 2016 (in comparative prices), suggesting a non-price market expansion.
- Foreign agricultural trade in 2015 declined in volume terms. Exports dropped by 14.6 percent to US\$ 16.2 bn, and imports shrank by 33.4 percent to US\$ 26.6 bn. Nevertheless, foreign agricultural trade trends were somewhat better than the general trend for Russian foreign trade during 2015. As a result, the share of agricultural products in Russia's total exports and imports in 2015 increased to 4.7 and 14.5 percent respectively.
- Russia's foreign trade in seeds in 2015 followed the general pattern of a decline in nominal terms. Import of seeds accounted for just 0.9 percent of Russia's total agricultural imports, while the country's dependence on imports of seeds remains high.
- The dynamics of agricultural exports improved in 1H 2016, with exports growing by 3.8 percent in value terms to US\$ 7.4 bn, and the export of seeds increasing by 73.1 percent. Agricultural imports continued to decline, but at a lower rate. In 1H 2016, foreign agricultural trade continued to perform better than Russia's foreign trade in general.
- Food prices rose at a faster rate than prices in general, making food economically less affordable.
- Macroeconomic factors affecting the agricultural sector included the Ruble depreciation and high inflation rate, making materials & resources and loans less affordable for agricultural producers.
- The financial standing of agricultural producers strengthened in 2015. The level of profitability in the sector increased. Despite the rising payables, total debt, including wage arrears, went down. Agricultural producers' solvency improved, their profit margins grew to 22.3 percent (if subsidies are taken into account). Some producers started to enter international markets, such as the EU, Egypt, UAE, and the Southeast Asia.
- In 2015-1H 2016, major agricultural support measures included government-support investment loans (with subsidized interest rates), and the extension of Russia's food import embargo until the end of 2017.

## Agricultural Sector Dynamics

Russia is number five in the world by gross grain production (5 percent of the world's total in 2014/15) after the U.S., China, EU and India. It is the world's largest producer of buckwheat, oats and barley.<sup>1</sup>

The contribution of the agricultural sector (including forestry and hunting) in the Russian GDP in 2015 rose by 0.4 percentage points (p.p.) to 3.9 percent.<sup>2</sup> The employment rate in the sector remained unchanged at 6.7 percent, or 4.8 mn people<sup>3</sup>, reflecting a moderately positive dynamics.

### Agricultural production

#### Plant cultivation

Cultivated arable land increased by 794,000 ha (1 percent) to 79,319,000 ha in 2015. This was mostly driven by a greater arable land used for cultivating wheat (1,556,000 ha more than in 2014), which represents around 1/3 (33.8 percent) of the total sown area. Land under some grain and fodder crops decreased. Analysis of by type of agricultural producer shows that it was private farms and private household plots that were mostly responsible for the arable land expansion (an increase of 1,073,000 ha, or 5.4 percent). As a result, the size of private farms in Russia grew to 2,800,0 ha, or 26.2 percent of the sown area. The rest belonged to agricultural enterprises.

In the context of growing arable land, the production (gross harvest) of key agricultural crops increased in 2015 (table 1). For example, the production of wheat increased despite a 0.5 percent decrease to 104.8 mn metric tonnes (MT) in gross grain production. The gross harvest was affected by a somewhat lower productivity for grain crops.

*Table 1. Production of major agricultural crops in 2015*

	2015, mn MT	% relative to 2014
Wheat	61.8	103.5
Sugar beet	39.0	116.5
Potatoes	33.6	106.8
Vegetables (grown in both open-field and greenhouse cultivation systems)	16.1	104.2
Sunflowers	9.3	109.5

Source: FSSS

<sup>1</sup> Eurasian Economic Union Grain Market Review, 2010-2014, [http://www.eurasiancommission.org/ru/act/prom\\_i\\_agroprom/dep\\_agroprom/monitoring/Documents/Обзор%20рынка%20зерна%20ЕАЭС.pdf](http://www.eurasiancommission.org/ru/act/prom_i_agroprom/dep_agroprom/monitoring/Documents/Обзор%20рынка%20зерна%20ЕАЭС.pdf)

<sup>2</sup> Federal State Statistics Service (FSSS), calculated based on the gross value added as specified in the OKVED (Russian acronym for the Statistical of Economic Activities in Russia), Section A, in current prices.

<sup>3</sup> FSSS, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/wages/labour\\_force/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/wages/labour_force/#)

## Animal breeding

The pig and poultry populations continued to grow, but the number of cattle kept declining. In particular, the dairy cattle herd was persistently becoming smaller. Meanwhile the 2015 milk production was at the 2014 level due to a better average milk yield per cow. The production of other dairy products increased (table 2).

*Table 2. Production of major animal products in 2015.*

	2015	% relative to 2014
Livestock and poultry for slaughter (live weight), '000 MT	13.451	104.2
Milk, mn MT	30.8	100.0
Eggs, billion	42.5	101.6

Source: FSSS

In value terms, total agricultural production grew by 16.6 percent to RUB 5,037.2 bn<sup>4</sup> (US\$ 83.0 bn<sup>5</sup>). Agricultural production in comparative prices grew by 3.0 percent in 2015 and 2.6 percent in 1H 2016<sup>6</sup>, suggesting a non-price market expansion. Both plant cultivation and animal raising contributed to the upward trend. Crop farming production grew by 18.6 percent (to RUB 2,636.8 bn, or US\$ 44.5 bn), and animal husbandry production increased by 14.5 percent (to RUB 2,400.4 bn, or US\$ 39.6 bn). The first half of 2016 saw a continued positive development for the agricultural market – an 11.0 percent increase to RUB 1,554.3 bn, or US\$ 25.6 bn.

## Foreign trade

Russia's primary export crop is wheat. In 2015, wheat and meslin (wheat and rye mixture seed) exports fell in volume terms by 4.1 percent to 21.2 mn MT and by 27.2 percent (to US\$ 5.4 bn) in money terms. However, it grew in 1H 2016 – by 36.9 percent YoY (to 9.3 mn MT) in volume terms and by 12.6 percent (to US\$ 1.6 bn) in value terms.<sup>7</sup> Egypt and Turkey were the main export markets for Russian wheat, accounting for 38.2 percent of total exports.

<sup>4</sup> FSSS; data for the Republic of Crimea and the City of Sevastopol taken into account

<sup>5</sup> Using the 2015 annual average ruble/US dollar exchange rate of 60.66

<sup>6</sup> FSSS, [http://www.gks.ru/free\\_doc/new\\_site/business/sx/tab-sel3.htm](http://www.gks.ru/free_doc/new_site/business/sx/tab-sel3.htm)

<sup>7</sup> Data from Russia's Federal Customs Service (FCS)



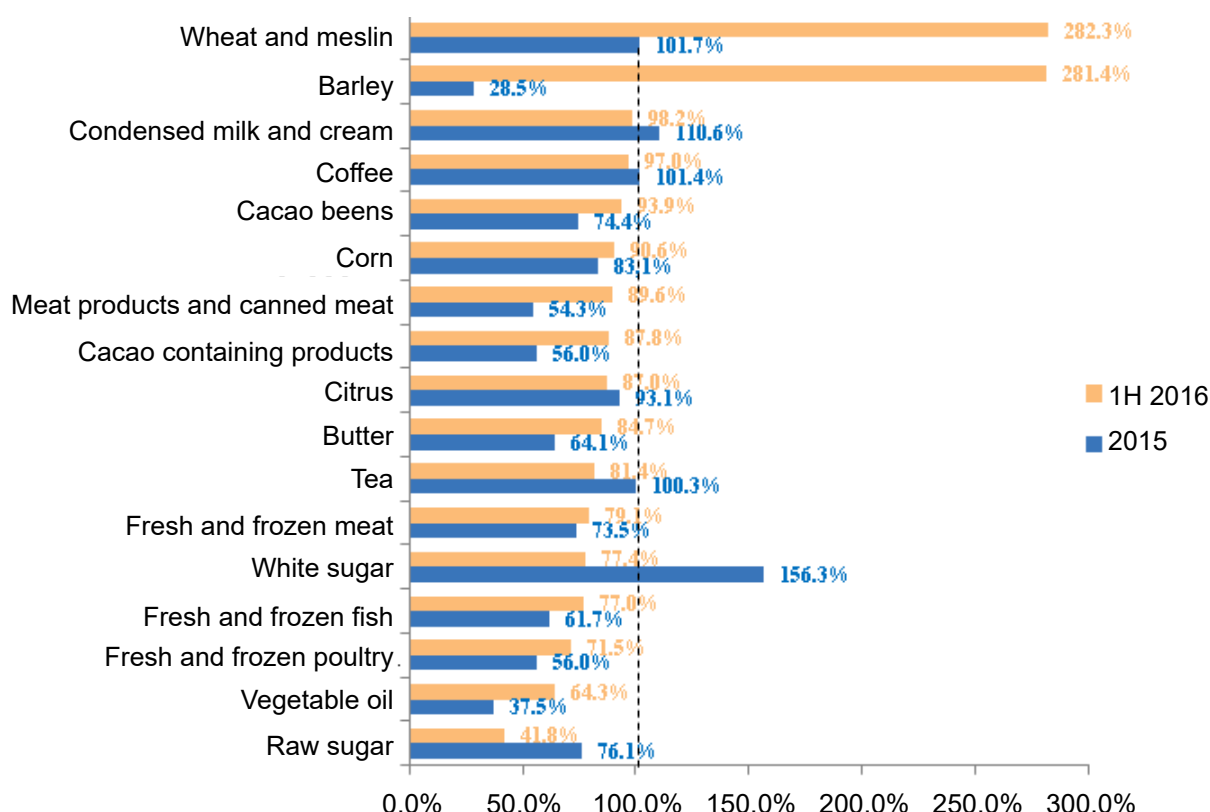


Fig. 1. Changes in Russia's imports of main agricultural products in 2015 and 1H 2016 (import items as specified in the Federal Customs Service's list. Source: Russia's Federal Customs Service (FCS).

Russia's primary import grain crop is rice, with import accounting for more than 30 percent of total rice consumption (31 percent in 2014). Other crop products with a high import to total consumption ratio are grapes (45.3 percent), apples and pears (29.4 percent). On the animal breeding front, the import/ total consumption ratio has historically been high for butter, cheese and curds, and low for pork and poultry products.

Foreign agricultural trade in 2015 declined in volume terms. Exports dropped by 14.6 percent to US\$ 16.2 bn, and imports shrank by 33.4 percent to US\$ 26.6 bn.<sup>8</sup> Nevertheless, foreign agricultural trade trends were somewhat better than the general trend for Russian foreign trade during 2015. As a result, the share of agricultural products in Russia's total exports and imports in 2015 increased to 4.7 and 14.5 percent respectively.

Seed industry products represented 1.7 percent of Russia's total agricultural exports and 0.9 percent of its total agricultural imports in 2015. Russia's foreign trade in seeds in 2015 followed the general pattern of a decline in value terms. Higher exports of some agricultural products was largely due to the low base effect from last year (table 3).

<sup>8</sup> Compared with 2014 r.for the EEC 01-24 foreign trade commodity group category (foodstuff and agricultural raw materials excepting those for the textile industry). Source: EEC, [http://www.eurasiancommission.org/ru/act/integr\\_i\\_makroec/dep\\_stat/tradestat/Pages/default.aspx](http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_stat/tradestat/Pages/default.aspx)

*Table 3. Russia's foreign trade in seed industry products in 2015.*

	Export, mn dollars	Change compared with 2014, %	Share of total seed mn dollars export in volume terms, %	Import, mn dollars	Change compared with 2014, %	Share of total seed imports in volume terms, %
Total volume of trade in seed industry products of which:	274.3	-17.9	100	226.8	-27.3	100
anise, anise-tree, fennel, coriander, thyme seeds and juniper berries	21.3	159.8	8	3.2	-4.1	1
flax seeds	137.0	-9.8	50	3.9	225.1	2
rape seeds	19.0	-73.1	7	15.5	-21.6	7
sunflower seeds	33.8	-19.4	12	162.4	-31.5	72
seeds and fruits of other oil plants	63.3	3.1	23	41.8	-16.9	18

Source: The Eurasian Economic Commission (EEC)

The 2015 seed market was worth RUB 50 bn (US\$ 824.3 mn), compared with RUB 42.0 bn (US\$ 692.4 mn) in 2014, including more than RUB 12 bn (US\$ 197.8 mn) of stock seeds. The imports-to-total-consumption ratio was 75.0 percent for sugar beet seeds, 44.0 percent for sunflower seeds, 45.0 percent for corn and 34.0 percent for vegetables.<sup>9</sup>

The dynamics of agricultural exports improved in 1H 2016, with exports growing by 3.8 percent in value terms to US\$ 7.4 bn, and the export of seeds of agricultural crops increasing by 73.1 percent (table 4). Agricultural imports continued to decline, but at a lower rate of 7.8 percent (to US\$ 11.7 bn). In 1H 2016, foreign agricultural trade continued to perform better on the whole than Russia's foreign trade in general.

*Table 4. Russia's foreign trade in seed industry products in 1H2016.*

	Exports, mn dollars	Change compared with 1H 2015, %	Share of total seed exports in volume terms, %	Imports, mn dollars	Change compared with 1H2015, %	Share of total seed imports in volume terms, %
Total volume of trade in seed industry products of which:	150.4	73.1	100	190.1	42.4	100
anise, anise-tree, fennel, coriander, thyme seeds and juniper berries	17.6	370.2	12	2.0	99.6	1
flax seeds	76.0	95.6	51	3.7	89.5	2
rape seeds	2.2	-73.2	1	18.6	68.3	10
sunflower seeds	39.4	92.4	26	146.8	46.6	77
seeds and fruits of other oil plants	15.2	-2.8	10	19.0	-1.7	10

Source: The Eurasian Economic Commission (EEC)

<sup>9</sup> Russia's Ministry of Agriculture, National Report on the Progress of Implementation of the Government program For The Agricultural Sector Development and Regulation of the Agricultural, Raw Materials and Food Markets in 2013-2020, [http://www.mcx.ru/documents/document/v7\\_show/34699..htm](http://www.mcx.ru/documents/document/v7_show/34699..htm)

Russian agricultural producers were increasing the output of major import substituting food products in 2015 and 1H 2016. (table 5).

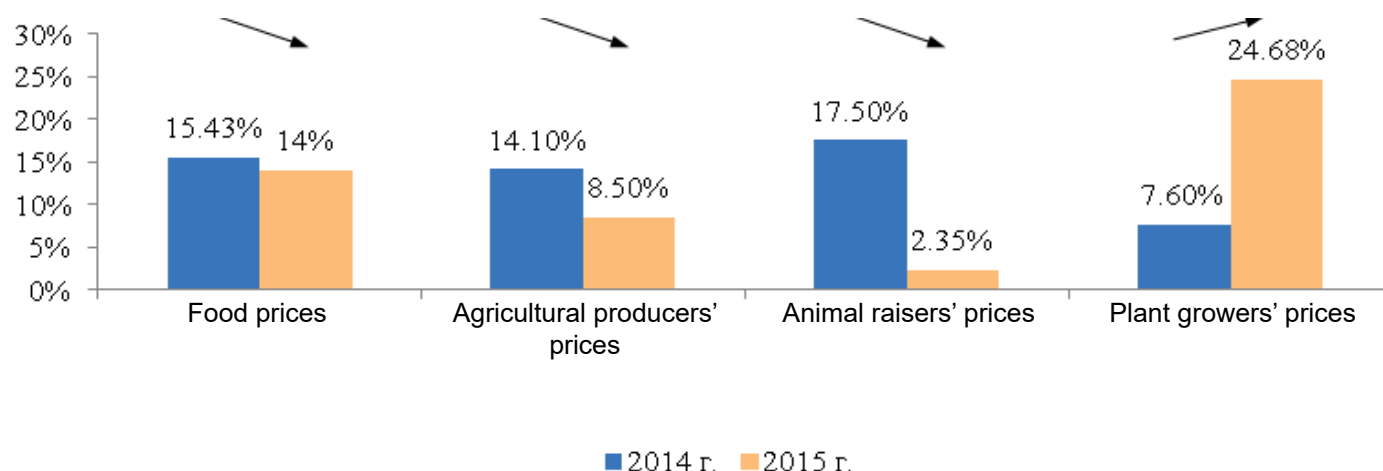
*Table 5. Russian production of major import substituting food products in 2015 and 1H 2016.*

	Import-to-total-consumption ratio (up to 2014)	Production in 2015	Production in 1H 2016
Cattle meat	23.4	113.4	103.4
Pork	12.1	115.5	116.1
Poultry	9.1	109.1	104.9
Butter	24.6	102.2	95.3
Cheese and cottage cheese	24.7	113.4	102.3

Sources: FSSS, EEC<sup>10</sup>

## Price Environment

2015 saw a slight deceleration in the growth of prices for agricultural products, excepting plant cultivation products (Fig. 2).<sup>11</sup>



*Fig. 2. Inflationary changes in the agricultural sector. Source: FSSS*

Food prices continued to rise at a faster rate than prices in general in 2015, with the Consumer Price Index (CPI) for food reaching 114 percent compared with a 112.91-percent CPI for consumer goods and services.<sup>12</sup> In 1H 2016, price changes for consumer goods and services and those for food were comparable (3.3 vs. 3.2 percent).<sup>13</sup>

<sup>10</sup> FSSS, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/importexchange/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/importexchange/#); EEC, EEU Food Safety 2014 Monitoring, [http://www.eurasiancommission.org/ru/act/prom\\_i\\_agroprom/dep\\_agroprom/monitoring/Documents/Мониторинг%20продовольственной%20безопасности%20Союза%202014.pdf](http://www.eurasiancommission.org/ru/act/prom_i_agroprom/dep_agroprom/monitoring/Documents/Мониторинг%20продовольственной%20безопасности%20Союза%202014.pdf) (p. 25)

<sup>11</sup> FSSS, December-to-December change, [http://www.gks.ru/free\\_doc/new\\_site/prices/potr/tab-potr1.htm](http://www.gks.ru/free_doc/new_site/prices/potr/tab-potr1.htm), [http://www.gks.ru/free\\_doc/new\\_site/prices/potr/tab-potr1.htm](http://www.gks.ru/free_doc/new_site/prices/potr/tab-potr1.htm)

<sup>12</sup> FSSS, [http://www.gks.ru/free\\_doc/new\\_site/prices/potr/tab-potr1.htm](http://www.gks.ru/free_doc/new_site/prices/potr/tab-potr1.htm)

<sup>13</sup> FSSS, against previous year's December, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/tariffs/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/tariffs/#)

In 2015, food became economically less affordable. The cost of the minimum consumer basket for food products was rising faster than average monthly wages (8.9 vs. 4.7 percent, see Table 6). The situation somewhat improved in 1H 2016, when the cost of the minimum consumer basket for food products increased 6.3 percent (to RUB 3,816.63), less than the monthly average wage (10 percent to RUB 37,404).

*Table 6. Economic affordability of some food products reflected by average consumer prices*

	2015, RUB/kg	Change (RUB), 2015/2014, %	2015, US\$/kg	Change (US\$), 2015/2014, %
Beef	314.9	15.7	5.2	-27.6
Pork	271.1	-0.5	4.5	-37.7
Chicken	133.7	-1.8	2.2	-38.5
Frozen fish	138.2	24.9	2.3	-21.8
Butter	397.8	11.2	6.6	-30.4
Sunflower oil	107.6	37.8	1.8	-13.7
Milk, l	47.6	8.7	0.8	-32.0
Cheese and curds	418.6	7.7	6.9	-32.6
Eggs, dozen	65.0	10.7	1.1	-30.7
Sugar sand	52.1	15.9	0.9	-27.4
Wheat flour	32.8	11.3	0.5	-30.4
Bread and bakery products	64.8	10.3	1.1	-31.0
Milled rice	67.9	28.0	1.1	-19.9
Potatoes	19.9	-25.3	0.3	-53.3
Apples	87.4	14.0	1.4	-28.7
Monthly average nominal wage, RUB	34 029.5	4.7	561.0	-34.5
Cost of minimum food basket	3 589.9	8.9	59.2	-31.9
US\$/RUB year average exchange rate (for reference), rubles	60.66	59.8	-	-

Source: FSSS<sup>14</sup>

The financial standing of agricultural producers strengthened in 2015. The proportion of profitable enterprises increased (to 83.1 percent), while the total number of agricultural producers reduced, reflecting the consolidation process. Despite the increasing payables, total debt, including wage arrears, went down. Agricultural producers' solvency improved, their current liquidity ratio reflecting short-term solvency, rose to 181.7 percent in 2015 from 160.9 percent in 2014, although this is still short of the indicative level (200 percent).

<sup>14</sup> FSSS, <http://www.gks.ru/dbscripts/cbsd/dbinet.cgi?pl=1923003>, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/wages/labour\\_costs/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/wages/labour_costs/#), [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/tariffs/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/tariffs/#),



Agricultural producers' profitability also improved, according to Russia's Ministry of Agriculture, their profit margins grew to 22.3 percent, if subsidies are taken into account), or 10.9 percent, if subsidies are not taken into account (against 6.3 percent in 2014). One negative development was a 5.6 percent decrease (to RUB 296.0 bn, or US\$ 4,880.2 bn) in investments in agricultural fixed assets<sup>15</sup>. The debt/total financing ratio also decreased due to the agricultural producers' unstable income base and high debt burden, constraining their borrowing capacity. Wages in the sector are still twice as low as in the economy in general.

## Largest Market Players

### Miratorg Agribusiness Holding

Miratorg Agribusiness Holding (Miratorg ABH) is one of Russia's largest vertically integrated meat producers. The company's operating results improved in 2015. The production of poultry increased 2.5x to 75,600 MT. Miratorg ABH intends to expand its poultry production through its meat processing project and new distribution channels, including the launch of a halal chicken production line to facilitate the entry to the CIS and beyond-the-CIS markets and getting an EU attestation of conformity (in April 2016, the company announced the beginning of poultry supplies to Italy)<sup>16</sup>.

Miratorg's pork production in 2015 grew by 11 percent to 413,900 MT (in live weight). The company intends to increase pork output by rising cost effectiveness, launching new projects and expanding export sales to countries, such as China and Southeast Asia. The company's beef business was expanding at a fastest rate, from 3,300 MT in 2014 to 40,500 MT in 2015. This was due to a number of achievements, including an increase in the company's cattle herd, launch of seven new farm projects in 2015, greater use of agricultural land to grow fodder crops, launch of a new processing and packaging line to expand the product range, and the pilot deliveries to the United Arab Emirates.

The company harvested 908,000 MT of grain and legumes in gross terms in 2015, a 56 percent increase YoY, thanks to the opening up of new lands and raising the productivity of its land bank resources through the use of advanced technology and harvesting techniques.<sup>17</sup>

The company's financial performance generally improved in 2015, with consolidated IFRS revenue rising by 30.1 percent to a new record level of RUB 96.3 bn<sup>18</sup> (US\$ 1,587.5 mn) and EBITDA increasing 9.2 percent to RUB 25.3 bn<sup>19</sup> (417,1 млн долл. США). US\$ 417.1 mn). EBITDA margin in 2015 was 26.3 percent, a 5 p.p. decrease YoY.

<sup>15</sup> FSSS, in actual prices

<sup>16</sup> Miratorg, [http://www.miratorg.ru/about/news/\\_layouts/listform.aspx?PageType=4&ListId={8FE12461-9588-46EA-AE17-A3B612824453}&ID=338&ContentTypeID=0x010030F5A0BF7CAB954A94821673F986897B](http://www.miratorg.ru/about/news/_layouts/listform.aspx?PageType=4&ListId={8FE12461-9588-46EA-AE17-A3B612824453}&ID=338&ContentTypeID=0x010030F5A0BF7CAB954A94821673F986897B)

<sup>17</sup> Miratorg, <http://www.miratorg.ru/about/news/Lists/List/NewsView.aspx?ID=327&ContentTypeID=0x010030F5A0BF7CAB954A94821673F986897B>

<sup>18</sup> Corporate Governance Disclosure (website), <https://www.e-disclosure.ru/portal/files.aspx?id=10610&type=4>

<sup>19</sup> Estimated IFRS data (earnings for reporting year, with income and expenses Profit Tax, depreciation and amortization taken into account)

Miratorg's debt burden rose in 2015. Its total debt was up 16.1 percent to RUB 80.0 bn (US\$ 1,318.8 mn), driven by the short-term component increase, and the short-term-to-total-debt ratio reached 57.5 percent. The net debt rose by 18.8 percent to RUB 77.3 bn<sup>20</sup> (US\$ 1,274.3 mn). However, Miratorg's debt burden was within the indicative range, as the net debt/operating EBITDA ratio was 3.1x.

The company's income continued to grow in 1H2016 (a 8.3 percent increase to RUB 25.8 bn<sup>21</sup>, or US\$ 425.3 mn, according to Miratorg's unaudited IFRS financials.

## Rusagro Group

Rusagro is a vertically-integrated producer of sugar, pork, crops, oils and fats. It is a leading Russian manufacturer of lump sugar (with 37 percent share of the Russian market) and margarine (45.1 percent). It is also the country's second-largest producer of pork (6 percent), third largest sugar producer (14 percent) and fifth largest mayonnaise manufacturer (10.9 percent).

At year-end 2015, Rusagro was owned by the family of V.N. Moshkovich (75.0 percent of shares), the company's management and Board members (6.9 percent), and Ros Agro PLC (the Cyprus-based parent company; 1.8 percent). The rest 16.3 percent of the company's shares are floated in the market. Rusagro got a LSE listing after an IPO implemented in London in 2011.<sup>22</sup> The company continued to buy back its GDRs in 2015, in line with the Board's decision of 2011. At year-end 2015, 1.84 percent of the total GDR issue had been bought back.

Rusagro's operating performance generally improved in 2015. Sugar and pork production increased by 6.8 and 4.3 percent to 766,000 MT and 195,000 MT (live weight) respectively. The group's land bank expanded by 1.8 percent to 504,000 ha. Oil and fats shipments showed a mixed trend (while mayonnaise and dressings output increased by 12.1 percent to 65,000 MT, vegetable oil and margarine/spread production dropped by 18.6 and 8.5 percent to 153,000 MT and 43 MT respectively).

The group's 2015 financial performance was on an improvement path. According to Rusagro's IFRS consolidated financial statement, consolidated revenue increased 22.5 percent to RUB 72.4 bn<sup>23</sup> (US\$ 1,193.5 mn). Each of the group's four business divisions contributed to this, especially the sugar business, which increased its selling prices by 42 percent on average. The sugar division accounts for a lion's share (40 percent) of the group's total revenues.

EBITDA rose by 26.5 percent to RUB 25.8 bn<sup>24</sup> (US\$ 425.3 mn). Adjusted EBITDA grew

<sup>20</sup> Estimated IFRS data (long-term and short-term debt excluding cash and cash equivalents)

<sup>21</sup> Miratorg, [http://www.miratorg.ru/investors/SitePages/financial\\_statements\\_publisher.aspx](http://www.miratorg.ru/investors/SitePages/financial_statements_publisher.aspx)

<sup>22</sup> Global depositary receipts (GDR), ticker: AGRO

<sup>23</sup> Rusagro, 2015 Annual Corporate Report (p. 117)

<sup>24</sup> Estimated IFRS data (earnings for reporting year, with income and expenses Profit Tax, depreciation and amortization taken into account)

by 35 percent to RUB 24.4 bn<sup>25</sup> (US\$ 402.2 mn). Adjusted EBITDA margin increased by 3 p.p. to 34 percent. The group's agricultural and meat businesses were most profitable (with EBITDA margins of 47 and 42 percent respectively).

The group managed to increase its revenue by 17 percent to RUB 38.2 bn (US\$ 629.7 mn) in 1H 2016 compared to 1H 2015. Rusagro's agricultural business that had risen its average selling prices was the growth driver.

Rusagro's total debt grew 2.2x to RUB 49.9 bn (US\$ 822.6 mn), and its net debt increased 3.2x to RUB 15.5 bn (US\$ 249.7 mn) in 2015. The group's leverage, as the net debt/EBITDA ratio, rose to 0.6x in 2015 from 0.2x in 2014, suggesting that Rusagro was financially stable. The leverage increase was due to capex flows associated with Rusagro's ambitious investment plan, including construction projects in the Far East, modernization of sugar refineries, and procurement of new agricultural equipment. Rusagro's strategy is to become Russia's largest vertically integrated agricultural producer.<sup>26</sup>

## Cherkizovo Group

Cherkizovo Group is a vertically integrated holding company/ It is a top-3 player in the Russian poultry, pork and processed meat product markets and is the country's leading feed miller. The group' assets include poultry production facilities, feed mill plants and agricultural lands.

The group principal owner (61 percent as of year-end 2015) was the Cyprus-based MB Capital Europe Ltd , controlled by Babaev and Mikhailov and their family members<sup>27</sup>. The Norway-based Norges Bank has increased its stake to 5.7 percent.<sup>28</sup> Cherkizovo's shares are floated on the London Stock Exchange and Moscow Exchange.

Cherkizovo's operating performance generally improved in 2015. Poultry sales volumes increased by 12.9 percent to 470,400 MT. Sales of meat processing and crop cultivation products grew by 32.6 percent (to 191,200 MT) and 12.8 percent (to 267,400 MT) respectively. Unlike other business divisions, pork business showed a 3.8 percent decline in sales (to 163,700 MT) – as a result of the group's decision to close a pig breeding facility in Orel to improve the genetical pool of the herd for the next breeding cycle. The group is focusing on developing export channels. In 2016, Cherkizovo made its first deliveries of halal products to Tanzania<sup>29</sup> and Egypt<sup>30</sup>.

<sup>25</sup> Rusagro, 2015 Annual Corporate Report

<sup>26</sup> Rusagro, 2015 Annual Corporate Report

<sup>27</sup> Cherkizovo, the 2015 Annual Report

<sup>28</sup> The Moscow Exchange, data as of August 2016, [http://fs.moex.com/emidocs/2016/08/10/1215300\\_ENG-12926440.html](http://fs.moex.com/emidocs/2016/08/10/1215300_ENG-12926440.html)

<sup>29</sup> Issuer's reporting documents, The Moscow Exchange, [http://fs.moex.com/emidocs/2016/08/26/1222441\\_ENG-12945741.html](http://fs.moex.com/emidocs/2016/08/26/1222441_ENG-12945741.html)

<sup>30</sup> Issuer's reporting documents, The Moscow Exchange, [http://fs.moex.com/emidocs/2016/08/12/1216257\\_ENG-12929265.html](http://fs.moex.com/emidocs/2016/08/12/1216257_ENG-12929265.html)

Cherkizovo's 2015 financial performance showed a mixed trend. Its consolidated revenue increased 2 percent to RUB 77.0 bn (US\$ 1,269.4 mn) 65,000 MT, driven by an improved performance of the poultry and meat processing divisions that contributed 54 and 38 percent of the total revenue respectively. Adjusted EBITDA reduced by 26 percent to RUB 12.6 bn, or US\$ 207.7 mn, and the net profit fell by 60 percent to RUB 6.0 bn, or US\$ 98.9 mn. Adjusted EBITDA margin declined to 16.4 percent in 2016 from 24.7 percent in 2014. These negative developments were partially due to rising FX expenses (associated with the procurement of feed components, fertilized eggs and veterinary medicines). The group's revenue reduced by 26 percent to RUB 12.6 153,000 MT and 43 MT respectively).

The group's consolidated revenue dynamics was the same in 1H 2016 (up 7 percent YoY to RUB 38.8 bn, or US\$ 640.2 mn), while other metrics continued to deteriorate: Cherkizovo's adjusted EBITDA reduced by 58 percent to RUB 2.7 bn, or US\$ 44.5 mn, and net profit by 83 percent to RUB 0.9 bn, or US\$ 14.8 mn. This was due to a correction of average selling prices, rising operating costs and greater FX expenses.

Cherkizovo's total debt was up 48.0 percent to RUB 41.2 bn (US\$ 679.2 mn) in 2015. The net debt rose by 34.0 percent to RUB 35.0 bn (US\$ 577.0 mn). However, Cherkizovo's debt burden as the net debt/operating EBITDA ratio was 2.8x, that is, below the indicative range of 3.0x. At the end of 1H2016, the group's net debt was RUB 39.3 bn (US\$ 647.9 mn). The company invests heavily in new capacities and product quality improvement programs.

## OZK

United Grain Company (Russian Cyrillic: АО «Объединенная зерновая компания», OZK) is a state-owned infrastructure and trade company, and also one of the country's key grain exporters. It was founded in 2009 for the purpose of developing Russia's domestic grain market and raising its export potential.<sup>31</sup> OZK is a government grain intervention vehicle<sup>32</sup> responsible for allocations of the state intervention fund and its safekeeping. The Russian Government has a stake of 50 percent plus 1 share in OZK. The rest belongs to Summa Group, represented by Investor LLC.<sup>33</sup>

The company's assets include grain terminal facilities in ports, processing facilities and grain elevator. Its key asset is Novorossiysk Bakery (NB) export port terminal.<sup>34</sup>

The company's operating performance reflected the intensified government grain interventions. Around 1.7 mn MT of harvested grain worth RUB 17.7 bn (US\$ 291.8 mn) was purchased from agricultural producers for the intervention fund during August 2015 –

<sup>31</sup> RF President's Decree #290, dated 20 Mar 2009 On the United Grain Company

<sup>32</sup> Government grain interventions is the principle mechanism of controlling the grain market, which includes procurement interventions (purchases of agricultural produce from producers) and commodity interventions (sales of products from an intervention fund)

<sup>33</sup> According to the latest annual report available (2014), [http://www.oaoozk.com/images/data/gallery/11\\_768\\_OZK\\_2014.pdf](http://www.oaoozk.com/images/data/gallery/11_768_OZK_2014.pdf)

<sup>34</sup> OZK, <http://www.oaoozk.com/ru/>

April 2016 through a grain exchange. This exceeds the result for the previous procurement period (September 2014 – June 2015) by 44.0 percent on volume terms and 72.5 percent on value terms<sup>35</sup> due, among other things, to a 2.3-23.2 percent (depending on grain type and region) increase in minimum procurement prices for grain harvested in 2015.<sup>36</sup>

All agricultural producers that had participated in the government grain intervention process in 2014-2015 could take part in purchasing a small (71,000 MT worth RUB 505 mn, or US\$ 8.3 mn) amount of grain, accounting for just 4.2 percent of the total 2015 harvested grain procurement as part of the procurement procedure.<sup>37</sup>

OZK's 2015 financial performance showed a mixed trend. Its revenue, calculated according to the Russian GAAP, decreased 4.9 percent to RUB 16.27 bn (US\$ 268.2 mn<sup>38</sup>) as a result export sales decline due to macroeconomic turbulence and introduction of a wheat export duty. Meanwhile, the company's net profit (before revaluation of NB shares worth RUB 14.73 bn, or US\$ 242.8 bn) grew 4.5x to 1.5 bn<sup>39</sup> (US\$ 24.7 mn). The profit growth was driven by higher cost effectiveness and lower prime costs.

In 2015, OZK's leverage increased 46.8 percent to RUB 18.5 bn (US\$ 305.0 mn) due to a greater long-term debt component, which reached 82.3 percent of the total debt (RUB 14.3 bn, or US\$ 235.7 mn) following the capex program implementation. The financial strength ratio of 0.78x was above the indicative level of 0.6x.

## Government Support Policy

The Russian Government supports the agricultural sector in line with the State Program for Development of Agriculture and Regulation of Agricultural Commodities Markets in 2013-2020.<sup>40</sup> In 2015, the Program allocated RUB 49,349.9 mn (US\$ 813.5 mn) for the development of agriculture and implementation of additional anti-crisis measures.

Major agricultural support measures include government-support investment loans (with subsidized interest rates).<sup>41</sup> Special support is available to help the manufacturers of agricultural technology.<sup>42</sup> Subsidizing of a multi-peril crop insurance system is encouraged by reimbursing 50 percent of insurance premium to the farmer<sup>43</sup>. Export endorsement institutes, such as ESKAR, ROSEXIMBANK, and the Russian Export Center he been

<sup>35</sup> OZK, <http://www.oaoozk.com/ru/intervention/>

<sup>36</sup> Order # 119 of 31 Mar 2015 On The Minimum Prices for 2015 Harvested Grain To Be Applied For Government Grain Interventions in 2015-16

<sup>37</sup> OZK, <http://www.oaoozk.com/ru/press/news/534.htm>

<sup>38</sup> Using the 2015 annual average ruble/US dollar exchange rate of 60.66

<sup>39</sup> OZK, <http://www.oaoozk.com/ru/press/news/511.htm>

<sup>40</sup> RF Government Decree # 717, dated 14 July 2012

<sup>41</sup> RF Government Decree # 1460, dated 28 Dec 2012, On The Approval of Guidelines Regarding Subsidies To Regional Governments For Crop Insurance Development And Reimbursement Of Loans Issued By Russian Banks And Agricultural Credit Cooperatives

<sup>42</sup> RF Government Decree # 1432, dated 27 Dec 2012, On The Approval of Guidelines Regarding Subsidies To Regional Governments For The Agricultural Sector Technical And Technological Modernization.

<sup>43</sup> RF Government Decree # 1371, dated 22 Dec 2012, On The Approval of Guidelines Regarding Subsidies To Regional Governments For Partial Reimbursement Of Insurance Premiums To Agricultural Producers



established to encourage and support agricultural exports.

Government support is available for the seed industry in the form of subsidizing farmers' expenses related to the procurement of stock seeds (such as spiked grain, incl.oat, and cereal, incl. sorghum, rice and maize, seeds), as well as seeds to be delivered to the Far North to cultivate fodder crops. Another support mechanism is the promotion of lending for the development of seed selection and breeding centers through interest rate subsidizing. In 215, the Agricultural Lending Coordination Commission approved an investment project worth RUB 49.8 mn, or US\$ 0.8 mn (equivalent to loan agreement size) for Kursk Oblast.<sup>44</sup>

The government carries out commodity interventions (through OZK) to control the agricultural market<sup>45</sup>, using both tariff- and nontariff-based measures. Since grain is a strategic good for the Russian domestic market, the government may from time to time impose temporal restrictions or bans on grain export.<sup>46</sup> From 1st July 2015 Russian wheat is subject to a perpetual export duty of 50 percent of customs value, minus RUB 6,500 (US\$ 107.2) per MT.<sup>47</sup> In addition, the Customs Union Commission Technical Guidelines *On Grain Safety*<sup>48</sup> defines grain as a good subject to epidemiological scrutiny<sup>49</sup>, quarantine and phytosanitary inspections<sup>50</sup>, and fodder crop seeds as a good subject to veterinary surveillance<sup>51</sup> at the points of entry to the Customs Union member states.

Meanwhile, Article 95 of the Eurasian Economic Union Treaty of 29th May 2014 and Annex 29 to this Treaty (Protocol On Government Agriculture Support Policy) specifies the responsibilities for agriculture support applying to different governments and the liability for non-compliance with it.<sup>52</sup>

In 2016 (6th Aug), Russia extended its food import embargo that had been in place for already two years (from 6th Aug 2014) until 31st Dec 2017. The embargo extends to meat and dairy products, fish, vegetables, and fruit from the EU, U.S.A., Canada, Australia, and Norway.<sup>53</sup> Albania, Montenegro, Iceland and Lichtenstein were included in the list of countries whose suppliers were banned in August 2015, and a food embargo against Ukraine was imposed in January 2016<sup>54</sup>. Food imports from Turkey were banned from 1st Jan 2016, but the lifting of the ban is currently discussed.

<sup>44</sup> Russia's Ministry of Agriculture, <http://www.mcx.ru/>

<sup>45</sup> Article 3 of Federal Law #4973-1 On Grain dated 14 May 1993, RF Government Decree # 580, dated 11 May 1993 On Measures To Encourage The Approval of Guidelines Regarding Public Procurement And Commodity Interventions, Intended To Control The Agricultural, Raw Material And Commodity Markets, RF Government Decree # 168, dated 3 Aug 2001, On Measures To Encourage the Growth of Organized Goods Turnover Through Commodity Exchanges

<sup>46</sup> Customs Union Commission decision # 168 of 27 Jan 2010

<sup>47</sup> RF Government Decree # 754, dated 30 Aug 2013, On the Approval of Custom Duty Rates for Goods Exported from the Russian Federation to the Customs Union Member States and Invalidation of Some Legal Acts of the Russian Federation Government»

<sup>48</sup> Customs Union Commission decision # 874 of 9 Dec 2011

<sup>49</sup> Customs Union Commission decision # 299 of 28 May 2010

<sup>50</sup> Customs Union Commission decision #318 of 18 June 2010

<sup>51</sup> Customs Union Commission decision #317 of 18 June 2010

<sup>52</sup> EEC, [http://www.eurasiancommission.org/ru/act/prom\\_i\\_agroprom/dep\\_agroprom/sxs/Pages/default.aspx](http://www.eurasiancommission.org/ru/act/prom_i_agroprom/dep_agroprom/sxs/Pages/default.aspx)

<sup>53</sup> RF Government Decree # 608, dated 30 June 2016, On The Amendments To The RF Government Decree # 778, dated 7 Aug. 2014

<sup>54</sup> RF Government Decree # 1397, dated 21 Dec 2015, On the Amendment of Item 1 of the RF Government Decree # 778 dated 7 Aug 2014



32A, Khoroshevskoe shosse, Moscow, 123007  
Tel/Fax: +7 (495) 775-59-02, 775-59-01  
[www.ra-national.ru](http://www.ra-national.ru)

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[pr@ra-national.ru](mailto:pr@ra-national.ru)

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